



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

200220030

Date: *APRIL 8, 2002*

UIL: 507.04-00

Contact Person:

Identification Number:

Contact Number:

*T: EO. B3*

Employer Identification Number:

LEGEND:

A =

B =

C =

W =

X =

Y =

Z =

Dear Sir or Madam:

This is in response to a ruling request submitted on your behalf by your authorized representatives. You are seeking rulings on the effects under section 507 and Chapter 42 of the Internal Revenue Code of a proposed transaction as more fully set forth below.

You have represented that X is a foundation created by W, a for-profit corporation. W contributed all or substantially all of the funds received by X and is a substantial contributor to X. X has been recognized as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) and is a private foundation described in section 509(a).

The current members of X's Board of Directors are A, President, B, Vice president, and C, Secretary and Treasurer.

*159*

A was the controlling shareholder of W who sold its operating assets to a third party and changed its name to Y. It is not anticipated that Y will provide additional funding to X. Further, as a result of the sale of the operating assets of W, there is no longer a corporate need for a foundation making distributions in the community formerly served by W.

Z is a foundation that has also been recognized as an exempt organization described in section 501(c)(3) of the Code and is classified as a private foundation under section 509(a). A and B who are husband and wife are substantial contributors to Z. The current directors of Z are A, President, and B, Secretary and Treasurer.

To facilitate charitable objectives and to reduce administrative costs, X proposes to transfer all of its net assets to Z.

You further represent that X does not intend that this request constitute notice of its intention to terminate its status as a private foundation under section 507(a)(1) of the Code, and intends to continue in existence for a short period of time following the proposed transfer of assets to Z.

After the transfer of its assets to Z, X will have no assets. At some time after the transfers, X expects to dissolve and to provide voluntary notice to the Internal Revenue Service of its intention to terminate its private foundation status under section 507(a)(1) of the Code.

X has never received notice that its status as a private foundation has been terminated nor has X committed willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability under Chapter 42 of the Code.

X currently has no grants outstanding that require the exercise of expenditure responsibility under section 4945. However, should such grants be made, the responsibility for such grants will be transferred to Z. X will pay all foundation excise taxes, if any, imposed by section 4940 that it will owe as of the date of the transfer to Z.

Y will function separately from X and Y will not use the name of X.

Section 507(a)(1) of the Code provides that the status of an organization as a private foundation shall be terminated if the organization notifies the Secretary or his delegate in the manner prescribed in the Income Tax Regulations of its intent to accomplish such termination and the organization pays the tax imposed by section 507(c) or the tax is abated under section 507(g).

Section 507(b)(2) of the Code provides that, in the case of termination of an organization's private foundation status, where there is a transfer of assets of any private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee private foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes a tax on each organization described in section 507(a)

equal to the lower of the amount which the private foundation substantiates by adequate records or other corroborating evidence as the aggregate tax benefit resulting from the section 501(c)(3) status of such foundation, or the value of the net assets of the foundation.

Sections 1.507-1(b)(6) and (7) of the Income Tax Regulations state that a transfer of all or part of a private foundation's assets to one or more other private foundations pursuant to section 507(b)(2) of the Code will not result in the termination of the transferor foundation's status as a private foundation unless the transferor elected to terminate under section 507(a)(1) or section 507(a)(2) if applicable.

Section 1.507-3(a)(1) of the regulations provides that a section 507(b)(2) transfer results in a carryover of certain tax attributes and characteristics of the transferor foundation to the transferee foundation.

Section 1.507-3(a)(2) of the regulations provides that a transferee private foundation succeeds to the part of the transferor's "aggregate tax benefit" that is attributable to the assets transferred, based on the transferor's assets held just before the transfer. However, the fair market value of assets held and transferred is determined at the time of transfer.

Section 1.507-3(a)(3) of the regulations provides that for purposes of section 507(b)(2) of the Code, in the event of a transfer of assets described in section 507(b)(2), any person who is a "substantial contributor" with respect to the transferor foundation shall be treated as such with respect to the transferee foundation, regardless of whether the person meets the \$5,000 - two percent limit with respect to the transferee organization at any time.

Section 1.507-3(a)(4) of the regulations provides if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in section 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Section 1.507-3(a)(5) of the regulations provides that [except as provided in subparagraph 1.507-3(a)(9)] a private foundation is required to meet the distribution requirements of section 4942 of the Code for any taxable year in which it makes a section 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward satisfaction of the requirements to the extent the amount transferred meets the requirements of section 4942(g).

Section 1.507-3(a)(7) of the regulations provides that [except as provided in subparagraph 1.507-3(a)(9)] where the transferor had disposed of all of its assets section 4945(d)(4) and (h) shall not apply to the transferee or the transferor with respect to any "expenditure responsibility" grants made by the transferor.

Section 1.507-3(a)(8)(ii) of the regulations provides that the provisions enumerated in subparagraphs (a) through (g) apply to a transferee foundation to the same extent and in the same manner that they would have applied to the transferor foundation had the transfer described in

section 507(b)(2) not been effected.

Section 1.507-3(a)(9) of the regulations provides that if a private foundation transfers all its net assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, then for purposes of chapter 42 (section 4940 et seq.) and part II of subchapter F of chapter 1 of the code (sections 507 through 509) such a transferee foundation will be treated as if it were the transferor.

Section 1.507-3(a)(9)(iii) (Example 1) of the regulations indicates that a transferee private foundation will be permitted to take advantage of any special rules or savings provisions with respect to chapter 42 to the same extent as the transferor could have if the transferor had continued its existence.

Section 1.507-3(a)(9)(iii) (Example 2) of the regulations indicates that when all net assets are transferred from one private foundation to a controlled foundation or foundations there are no expenditure responsibility requirements which must be exercised under sections 4945(d)(4) and (h) with respect to the transfer. The example further indicates that where the transferor foundation has outstanding grants for which it is required to exercise expenditure responsibility under sections 4945(d)(4) and (h), absent a specific provision for exercising expenditure responsibility by one of the transferees, all of the transferee foundations shall be required to exercise expenditure responsibility with respect to such outstanding grants.

Section 1.507-3(c)(1) of the regulations provides that for purposes of section 507(b)(2) the terms "other adjustment, organization or reorganization" shall include a significant disposition of assets.

Section 1.507-3(c)(2) provides that the term "significant disposition of assets" includes any disposition by a foundation in a taxable year to one or more other private foundations which is 25 percent or more of the fair market value of the net assets of the distributing foundation at the beginning of the taxable year.

Section 1.507-3(d) of the regulations provides that unless a private foundation gives notice under section 507(a)(1) of the Code, a transfer of assets described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status.

Section 1.507-4(b) of the regulations provides that private foundations that make transfers described in section 507(b)(1)(A) or (2) of the Code are not subject to the tax imposed under section 507(c) with respect to such transfers unless the provisions of section 507(a) become applicable.

Section 1.507-6(a)(2) of the regulations provides that, for purposes of the self-dealing provisions of section 4941 of the Code, the term "substantial contributor" shall not include any organization which is described in section 501(c)(3).

Section 4940 of the Code imposes a tax of 2 percent each year on the net investment

income of each private foundation. Net investment income is determined by subtracting expenses and modifications from the sum of gross investment income and capital gain net income.

Section 4941(a) of the Code provides for the imposition of taxes on acts of self-dealing between a private foundation and disqualified person.

Section 4941(d)(1)(E) of the Code states that the term "self-dealing" means any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4942(a) of the Code imposes a tax on the undistributed income of a private foundation. Section 4942(c) defines undistributed income as the amount by which the distributable amount exceeds the qualifying distributions of the foundation.

Section 4942(g)(1)(A) provides that the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to: (i) an organization controlled directly or indirectly by the transferor foundation or by one or more disqualified persons with respect to the foundation, except as provided in section 4942(g)(3), or (ii) any private foundation that is not an operating foundation under section 4942(j)(3), except as provided in section 4942(g)(3).

Section 4944(a) of the Code imposes a tax on a private foundation if it invests any amount in such a manner as to jeopardize the carrying out of its exempt purpose.

Section 4945(a) of the Code imposes an excise tax on the taxable expenditures made by a private foundation. Section 4945(d)(4) provides, in part, that the term "taxable expenditure" means any amount paid or incurred as a grant to an organization [other than a public charity described in section 509(a)(1), (2), or (3)], unless the private foundation exercises expenditure responsibility in accordance with section 4945(h).

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" includes any amount paid by a private foundation as a grant to an organization [other than an organization described in sections 509(a)(1), (2), or (3)] unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h).

Section 4945(h) of the Code provides that expenditure responsibility means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary or his delegate.

Section 6033 of the Code provides that every organization exempt from taxation under section 501(a) shall file an annual return, except any organization (other than a private foundation, as defined in section 509(a)) the gross receipts of which in each taxable year are normally not more than \$5,000.

Section 53.4941(d)-3(c)(1) of the Foundation and Similar Excise Taxes Regulations provides in general that except in the case of a Government official (as defined in section 4946(c)), the payment of compensation (and the payment or reimbursement of expenses, including reasonable advances for expenses anticipated in the immediate future) by a private foundation to a disqualified person for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if such compensation (or payment or reimbursement) is not excessive. Example (1) of Subsection (2) provides that the payment of compensation by a private foundation to a disqualified person shall not constitute an act of self-dealing if the services performed are reasonable and necessary for the carrying out of the private foundation's exempt purposes and the amount paid by the private foundation for such services is not excessive.

Section 53.4945-5(b)(7) of the regulations provides that for rules relating to the extent to which the expenditure responsibility rules contained in section 4945(d)(4) and (h) and this section relate to transfers of assets described in section 507(b)(2), see sections 1.507-3(a)(7), 1.507-3(a)(8)(ii)(f) and 1.507-3(a)(9) of the regulations.

Section 53.4945-6(b)(2) of the regulations provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrance of such expenses in such amounts was consistent with ordinary business care and prudence.

Section 53.4945-6(c)(3) of the regulations provides that a transfer of assets of a private foundation under section 507(b)(2) of the Code is not a taxable expenditure if such transfer is to an organization described in section 501(c)(3).

Section 53.4946-1(a)(8) of the regulations provides that for the purposes of section 4941 of the Code, the term "disqualified person" does not include any organization described in section 501(c)(3).

Rev. Rul. 78-387, 1978-2 C.B. 270, holds that when a transferee foundation is treated as the transferor under section 1.507-3(a)(9) of the regulations, the transferee is entitled to reduce its distributable amount under section 4942 by the amount of the transferor's excess qualifying distribution carryover.

The transfer to Z will be of all of X's assets. X will not receive any consideration for the transfer. Since Z is classified as an organization described in section 501(c)(3) and as a private foundation, the transfer is described in section 507(b)(2). In addition, since transfers described in section 507(b)(2) will not cause a termination of an organization's status as a private foundation, the transfer of all of X's assets will not terminate X's status as a private foundation. Furthermore, since X has not notified the Service of its intention to accomplish a termination at the time of the transfer and because there is no evidence that X has either been notified of any involuntary termination or has committed any acts which could trigger an involuntary termination, the transfer

of its assets to Z will not cause the imposition of the termination tax under section 507(c).

Because Z has been recognized by the Service as exempt from tax under section 501(c)(3) of the Code, the transfer of X's assets to Z will not constitute a payment for a non-charitable purpose and will be described within section 53.4945-6(c)(3) of the regulations.

Section 1.507-3(a)(7) of the regulations provides that when all assets are transferred to transferees that are not controlled by the same persons who control the transferor neither the transferor or the transferee will be required to exercise expenditure responsibility. Therefore, Z will not have to exercise expenditure responsibility over grants made by X prior to the transfer.

Section 53.4946-1(a)(8) of the regulations indicates that for purposes of section 4941, the term "disqualified person" does not include any organization described in section 501(c)(3) of the Code. Since Z is described in section 501(c)(3) of the Code, it will not be treated as a disqualified person for purposes of section 4941. Thus, the transfer of assets by X to Z will not constitute an act of self-dealing under section 4941 of the Code.

Section 1.507-3(a)(2) of the regulations provides that a transferee private foundation succeeds to the part of the transferor's "aggregate tax benefit" that is attributable to the assets transferred, based on the transferor's assets held just before the transfer. Thus, because Z is an organization described in section 501(c)(3) of the Code and is classified as a private foundation, Z will succeed to X's aggregate tax benefit.

Section 1.507-3(a)(8) contains highly technical rules that apply to transferee foundations. These rules would apply to Z since it is an organization described in section 501(c)(3) of the Code and is classified as a private foundation.

X's transfer closely resembles example (2) in section 1.507-3(a)(9)(iii) of the regulations since in order to facilitate accomplishment of diverse charitable purposes, X, a private foundation, intends to transfer all of its assets to Z who would be treated as if it were X in the proportion the fair market value of the assets transferred bears to the fair market value of the assets of X immediately before the transfer. Since Z is treated as X rather than as the recipient of "expenditure responsibility" grants, there are no expenditure responsibility requirements which must be exercised under sections 4945(d)(4) and (h) of the Code with respect to the transfers of assets to Z.

The transfer by X of one hundred percent (100%) of its assets to Z does not constitute an act of self-dealing, because it is not to or for the use of a disqualified person.

Since Z has been recognized as exempt under section 501(c)(3) of the Code, the transfer of assets to it will not be considered a taxable expenditure.

Based on the information submitted and the representations made therein, we rule as follows:

1. The proposed transfer of X's assets to Z will qualify as a transfer described in

165

section 507(b)(2) of the Code will not constitute a termination of X's private foundation status under section 507(a).

2. The proposed transfer of X's assets to Z will not result in any tax under section 507(c) of the Code.

3. The transfer by X to Z will not be treated as a transfer to a newly created organization.

4. X's aggregate tax benefit will be treated as having been transferred to Z. X's proposed transfer to Z will be treated as a transfer of its assets subject to the amount of liability X may have incurred under Chapter 42 of the Code to the extent not satisfied by X.

5. As a result of the proposed transfer to Z, X's excess qualifying distributions carryovers for prior years, as defined in section 4942(i), if any, will be transferred to Z.

6. The proposed transfer to Z will not constitute an act of self-dealing and will not subject X's foundation managers and disqualified persons with respect to X to any tax under section 4941(a)(1) or (2) of the Code.

7. The proposed transfer to Z will not give rise to net investment income and, therefore, will not result in the imposition of tax under section 4940 of the Code.

8. The proposed transfer to Z will not constitute a jeopardizing investment within the meaning of section 4944(a) of the Code.

9. The proposed transfer to Z will not constitute a taxable expenditure and, therefore, will not subject X to tax under section 4945 of the Code.

10. The proposed transfer to Z will not subject X to any tax under section 4942(a) of the Code for failure to distribute income. X must still meet its distribution requirements under section 4942.

11. X will not have to exercise expenditure responsibility with respect to the proposed transfer of assets to Z, as long as X disposes of all of its assets.

12. X will not be subject to tax under section 507(c) of the Code if X informs the Internal Revenue Service of its intention to terminate its private foundation status in a later taxable year when it has no assets.

13. X will not be required to comply with the recordkeeping requirements of section 4942(g)(3)(B) of the Code with respect to the proposed transfer of all of its assets.

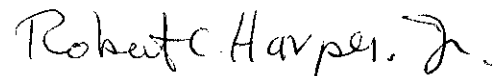
This ruling is directed only to the organization which requested it. Section 6110(k)(3) of the



Code provides that it may not be used or cited as precedent.

Because this ruling may help resolve future questions about your exempt status, you should keep a copy of this ruling in your permanent records.

Sincerely,

A handwritten signature in cursive script that reads "Robert C. Harper, Jr.".

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3